IT 00-7
Tax Type: **Income Tax**
Issue: **Commerce Clause (U.S. Const.) Controversy**
Trusts
Alternative Apportionment

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

"ALOYSIUS B. CARMICHAEL TRUST",	)	Docket No. 97-IT-0000
Taxpayer(s)	)	FEIN: 00-0000000
v.	)	Tax Years: 1994-95
THE DEPARTMENT OF REVENUE	)	John E. White,
OF THE STATE OF ILLINOIS	)	Administrative Law Judge

RECOMMENDATION FOR DISPOSITION RE:
THE PARTIES' CROSS-MOTIONS FOR SUMMARY JUDGMENT

Appearances: Jordan Goodman, Horwood, Marcus & Berk, appeared for taxpayer; Sean Cullinan, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

The "Aloysius B. Carmichael Trust" ("taxpayer" or "ABC Trust") filed amended returns to claim refund of the tax previously shown due on Illinois income tax returns filed regarding tax years ending December 31, 1994 and December 31, 1995. Taxpayer protested the Department's deemed denial of those returns, and requested a hearing. Taxpayer's amended returns and its protests were based on its claim that the Commerce Clause of the United States Constitution and the Due Process Clause of the Fourteenth Amendment prohibits Illinois from imposing income tax on its income.

The parties each filed Motions for Summary Judgment on the issue. Counsel submitted written and oral argument to support their respective motions. After

considering the parties' motions, I recommend that the Director grant the Department's Motion, deny the Trust's Motion, and finalize the Department's prior denial of the Trust's refund claims.

Statement of Material Facts Not in Dispute:

1. The "Aloysius B. Carmichael Trust" was established under the will of "Jane Doe". Joint Stipulation of Facts ("Stip."), ¶ 7.
2. "Jane Doe" was the settlor of the Trust. Stip. ¶ 4.
3. "Jane Doe" was a resident of Illinois at the time of her death. Stip. ¶ 5.
4. The estate of "Jane Doe" was probated in the Circuit Court of Cook County, Illinois. Stip. ¶ 8.
5. "Aloysius B. Carmichael" ("Carmichael") is the beneficiary of the Trust. Stip. ¶ 6. "Carmichael" was not an Illinois resident during either of the tax years at issue. *See id*., ¶ 9; *see also* Taxpayer's Motion for Summary Judgment, ¶ 4; Department's Cross-Motion for Summary Judgment, p. 2.
6. "Dominion Bank, Inc.", taxpayer's trustee, is located in Delaware. Stip. ¶ 10; Affidavit of "Janice Lester" ("Lester" Affidavit"), ¶ 5; 35 **ILCS** 5/1501(a)(20) (definition of "resident" does not include a corporation). The Trust is administered at the trustee's business address in Delaware. Stip. ¶ 12; "Lester" Affidavit, ¶ 7.
7. The res of the Trust consists of various securities and debt instruments. "Lester" Affidavit, ¶ 6. During the years at issue, none of the Trust's income was derived from sources within Illinois. Stip. ¶ 13.
8. Taxpayer is an Illinois resident, as that term is defined in § 1501(a)(20)(C) of the Illinois Income Tax Act ("IITA"). *See* Stip. ¶¶

Conclusions of Law:

Taxpayer's motion asserts that judgment should be entered for it because, as a matter of law, the Due Process Clause of the Fourteenth Amendment (U.S. Const., amend. XIV, § 1) and the Commerce Clause of the United States Constitution (U.S. Const., art. I, § 8) prohibit Illinois from levying a tax on its income. The Trust's due process argument is premised on its contentions: that no nexus exists between it and Illinois; that there is no connection between Illinois and the income by which tax was measured; and that Illinois provides no contemporaneous benefits or protections sufficient to justify the imposition of tax.

See Memorandum in Support of Taxpayer's Motion for Summary Judgment ("Taxpayer's Brief"), pp. 3-5. Taxpayer's Commerce Clause challenge is premised on its assertion that Illinois' income tax does not satisfy the four prong test announced in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977). Taxpayer's Brief, pp. 5-7. The Department's motion requests that, since there is no dispute that taxpayer is a resident of Illinois, and since the United States Constitution does not prohibit Illinois' ability to impose a tax measured by its resident's net income, judgment should be entered for it. Department's Cross-Motion for Summary Judgment, pp. 10-16.

Due Process:

In Quill v. North Dakota, 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992), the United States Supreme Court distinguished the analyses used to determine nexus under the Fourteenth Amendment's Due Process Clause, and under the Commerce Clause of the United States Constitution:

> Due process centrally concerns the fundamental fairness of governmental activity. **Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him. We have, therefore, often identified "notice" or "fair warning" as the analytic touchstone of due process nexus analysis.** In contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy. Under the Articles of Confederation, state taxes and duties hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these structural ills. See generally The Federalist Nos. 7, 11 (A. Hamilton). It is in this light that we have interpreted the negative implication of the Commerce Clause. Accordingly, we have ruled that that Clause prohibits discrimination against interstate commerce, see, e.g., Philadelphia v. New Jersey, 437 U.S. 617, 98 S.Ct. 2531, 57 L.Ed.2d 475 (1978), and bars state regulations that unduly burden interstate commerce, see, e.g., Kassel v. Consolidated Freightways Corp. of Del., 450 U.S. 662, 101 S.Ct. 1309, 67 L.Ed.2d 580 (1981).

Quill, 504 U.S. at 312, 112 S.Ct. at 1913 (1992).

There can be no doubt that, under a due process analysis of nexus, the Trust has been given fair warning that it was within Illinois' taxing jurisdiction. To begin, the IITA has, since 1969, imposed a "tax measured by net income ... on every individual, corporation, trust and estate ... on the privilege of earning or receiving income in ***or*** as a resident of [Illinois] ...." 35 **ILCS** 5/201(a). In the case of non-residents, tax is imposed upon the privilege of earning or receiving income *in* Illinois. In the case of residents, tax is imposed upon the privilege of earning or receiving income *as a resident of* Illinois. Here, taxpayer

stipulated that it was established (i.e., created) under the will of "Jane Doe", who was a resident of Illinois at the time of her death. Stip. ¶¶ 4-7. Thus, there is no dispute that taxpayer is a resident of Illinois, as that term is defined by the IITA. 35 **ILCS** 5/1501(a)(20)(C) ("The term 'resident' means: … [a] trust created by a will of a decedent who at his death was domiciled in this State ….").

The provisions and structure of the IITA distinguish between resident trusts and nonresident trusts, and treat them differently. Section 301 of the IITA allocates to Illinois all items of income earned or received by a resident trust, regardless of its source.[1] In contrast, for a nonresident trust, § 301(c) of the Act allocates to Illinois only those items of income or deduction referred to in Section 302, 303 or 304 (relating to compensation, non-business income and business income, respectively) which were taken into account when computing base income for the taxable year, and only to the extent provided by each such Section.[2]

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[1] Section 301 of the IITA provides, in part:

> General Rule.
>
> (a) Residents. **All items of income** or deduction **which were taken into account in the computation of base income for the taxable year by a resident shall be allocated to this State**.
>
> (b) Part-year residents. All items of income or deduction which were taken into account in the computation of base income for the taxable year by a part-year resident shall, for that part of the year the part-year resident was a resident of this State, be allocated to this State and, for the remaining part of the year, be allocated to this State only to the extent provided by Section 302, 303 or 304 (relating to compensation, non-business income and business income, respectively).

35 **ILCS** 5/301 (emphasis added).

[2] Section 301(c) provides:

> (c) Other persons.
>
> (1) In General. Any item of income or deduction which was taken into account in the computation of base income for the taxable year by any person other than a resident and which is referred to in Section 302, 303 or 304 (relating to compensation, non-business income and business income, respectively) shall be allocated to this State only to the extent provided by such Section.
>
> (2) Unspecified items. Any item of income or deduction which was taken into account in the computation of base income for the taxable year by any person other than a resident and which is not otherwise allocated or apportioned pursuant to Section 302, 303 or 304 (including, without limitation, interest, dividends, items of income taken into account under the provisions of Sections 401 through 425 of

The IITA's different treatment of resident trusts and non-resident trusts is purposeful. There are real and substantial differences between residents and non-residents for purposes of taxation, and the United States Supreme Court has long held that residency alone provides a separate and constitutionally justifiable basis for state taxation of all of a resident's income, from whatever source. Oklahoma Tax Commission v. Chickasaw Nation, 115 S.Ct. 2214, 2222-23 & nn.11-12 (1995); New York ex rel. Cohn v. Graves, 300 U.S. 308, 312-13, 57 S.Ct. 466, 81 L.Ed. 666 (1937). The fundamental distinction between residents and non-residents is based on a state's constitutionally limited (by principals of due process, equal protection and interstate commerce) power to tax only that portion of a non-resident's income that fairly reflects the non-resident's activities in the taxing state. Oklahoma Tax Commission v. Chickasaw Nation, 115 S.Ct. at 2222-23 & nn.11-12.

Notwithstanding its agreement that it is a resident trust, taxpayer contends that the undisputed facts show that it has no nexus with Illinois sufficient to justify the imposition of Illinois income tax. Taxpayer is certainly correct that persons associated with it, and its assets, were not physically present in Illinois during the years at issue. There is no dispute that the primary beneficiary of the Trust does not reside in Illinois, nor does the trustee. Stip. ¶¶ 5-6. The assets of the Trust include no real or tangible property having a physical situs within Illinois, and no income is earned from sources in Illinois. Stip. ¶¶ 6-7. But it must be recalled that the IITA's provisions do not condition a resident testamentary trust's taxability on whether the beneficiaries, trustees or assets of the trust maintain a physical presence in Illinois. *See* 35 **ILCS** 5/201(a), 5/301(a), 5/306, 5/1501(a)(20)(C). The very real and continuing contact the "Carmichael" Trust maintains with Illinois, like any trust created by a will of an individual who was

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> the Internal Revenue Code, and benefit payments received by a beneficiary of a supplemental unemployment benefit trust which is referred to in Section 501(c)(17) of the Internal Revenue Code):
>
> (A) In the case of an individual, trust or estate, shall not be allocated to this State; and
>
> (B) In the case of a corporation or a partnership, shall be allocated to this State if the taxpayer had its commercial domicile in this State at the time such item was paid, incurred or accrued.

35 **ILCS** 5/ 301.

resident of Illinois at the time of his death, is that such trusts owe their original, current and continuing existence to Illinois' probate and trust statutes, and to Illinois' court system.

"The Due Process Clause requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax, [citations omitted] and that the income attributed to the State for tax purposes must be rationally related to values connected with the taxing State." Quill, 504 U.S. at 306, 112 S.Ct. at 1909-10 (internal quotation marks omitted). The "Carmichael" Trust, the person being taxed here, is but one of the different types of artificial persons subject to Illinois income tax. 35 **ILCS** 5/1501(a)(18) (definition of "person"). Our supreme court has described a trust as being "[l]ike a corporation, a partnership, and an unincorporated association, [it] is an abstraction - a legal creation designed to enable natural persons who own property to achieve results that could not be achieved if they continued to own it as natural persons." Hanley v. Kusper, 61 Ill. 2d 452, 461, 337 N.E.2d 1, 6 (1975). While taxpayer focuses its argument on Illinois' lack of contacts with persons affiliated with it, or with the property it holds, it ignores the fact that it is an artificial person that exists only because of the operation of the laws of Illinois. Stip. ¶¶1-4; *see also*, Hanley v. Kusper, 61 Ill. 2d at 461, 337 N.E.2d at 6; Olheiser v. Shepard, 84 Ill. App. 2d 83, 228 N.E.2d 210 (1st Dist. 1967) (*citing* 90 C.J.S. Trusts §§ 261, 454).

Here, the estate of the settlor of the Trust was probated in the Circuit Court of Cook County, Illinois. Stip. ¶ 8; *see also* 755 **ILCS** 1/1-1 *et seq.* (Probate Act) (*formerly* Ill. Rev. Stat. ch. 110½, ¶ 1-1 *et seq.*). The Trust, thereby, was created, and continues to exist and to carry on its intended purposes, as a direct result of Illinois' positive laws and its courts' supervision and protection. Other states respect the Trust's existence as an artificial person because Illinois' court system supervised the "Carmichael" Trust's genesis as a unique legal entity. *See* U.S. Const., art. IV, § 1 (Full faith and credit among states). Most importantly, Illinois courts retain continuing and primary jurisdiction over any issues that might arise regarding the administration of a testamentary trust created by a will of an Illinois resident. Olheiser v. Shepard, 84 Ill. App. 2d at 90-91, 228 N.E.2d at 214-15. Thus, the Trust maintains a significant and continuing connection with Illinois.

Taxpayer relies on pre-Quill decisions from other jurisdictions to support its argument that there must be some actual physical presence, within Illinois, of some natural person or some tangible property connected with the trust, before Illinois is constitutionally permitted to tax its income. Specifically,

taxpayer cites Swift v. Director of Revenue, 727 S.W.2d 880 (Mo. 1987), Blue v. Michigan, 185 Mich. App. 406, 462 N.W.2d 762 (1990) and Taylor v. State Tax Comm., 445 N.Y.S.2d 648 (1981). The similar holdings of those decisions and others, however, were considered and rejected in District of Columbia v. Chase Manhattan Bank, 689 A.2d 539, 545-46 & n.10 (D.C. Ct. App. 1997). The facts in that case are similar in principal respects to those stipulated here. Chase Manhattan Bank, 689 A.2d at 540 & nn.2-3. That is to say, there, as in this case: the trustee did not reside in the District; nor did any beneficiary; no assets of the trust were situated in the District; and the trust was not administered within the District. Chase Manhattan Bank, 689 A.2d at 540-41.

One of the particular arguments the court confronted in Chase is similar to the "Carmichael" Trust's argument here, that the "statutory concept of a 'resident trust' under 35 ILCS 5/1501(a)(20) simply does not provide a constitutional justification for Illinois' imposition of a tax on all (or any) of the income of the Trust when neither the Trust nor its beneficiary, trustee, or assets receive any local benefit or protection whatever." Taxpayer's Memo, p. 5. In particular, the D.C. Court of Appeals confronted Chase Manhattan Bank's similar argument that a state could not classify a testamentary trust as a resident, and then use that status as a basis to tax a trust that lacks contacts with the taxing jurisdiction sufficient to satisfy the Due Process Clause. The court wrote:

> To a certain point, we agree. The fact that the District calls some entity - be it a trust, individual, or corporation - a "resident" does not, by itself, give the District any greater power over that entity than it would have in the absence of such a statutory classification. At least in the context of individuals and corporations, however, the concept of residency, if established by reference to sufficient minimum contacts, carries significant legal weight. As we have noted above, a state may tax the entire income of one of its residents (including a corporation), even if some or all of that income is earned in another state. The critical question, then, is whether the relationship between the District and the testamentary trust of one of its residents is sufficiently close to justify the District's classification of the trust itself as a resident for purposes of taxation.
>
> A testamentary trust of a District resident, which has been probated in the courts of the District of Columbia, has a relationship to the District distinct from the relationship, if any, between the District and the trustee or trust assets. The District's unquestioned power to resolve disputes over the trust and to order accountings to protect the trust corpus and beneficiaries from potential malfeasance by the trustee reflects the District's justifiable, though not necessarily exclusive, jurisdiction over the trust itself. ***
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> * * * *
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> As we already have noted, the Supreme Court has equated a state's power to exercise jurisdiction over an entity and the state's

> power to tax that entity. See supra part I.C (citing Quill, 504 U.S. at 308, 112 S.Ct. at 1910). Under this line of reasoning, therefore, the District's ties to the trust itself justify both the District's continuing, supervisory jurisdiction over the entire trust (irrespective of the absence of the trustees, trust assets, or trust beneficiaries from the District) and the District's taxation of the entire net income of the trust (also irrespective of the location of the trustee, trust assets, or trust beneficiaries).
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> The District's proffered analogy between a corporation and a testamentary trust proves quite useful in confirming the nexus between the District and the trust. A testamentary trust, like a corporation, is a creature of the laws of the state where it is created and owes its very existence to those laws. As the Supreme Court noted long ago in discussing the taxation of corporations: "[A corporation] must dwell in the place of its creation, and cannot migrate to another sovereignty. The fact that its property and business were entirely in another state did not make it any less subject to taxation in the state of its domicile." Cream of Wheat Co., 253 U.S. at 328, 40 S.Ct. at 559 (internal quotation marks and citations omitted). [footnote omitted]
>
> We see no constitutional barrier to the District's decision to treat a testamentary trust of one of its residents in a similar fashion. We conclude that the District's continuing, principal jurisdiction over the Lalor testamentary trust reflects a sufficient nexus between the District and the trust to justify the District's decision to treat the trust as a "resident" of the District for tax purposes. The District created the legal environment which permitted the trust to come into existence, established the trust when Lalor's will was probated, and has provided access to its courts to all parties with an interest (or potential interest) in the trust. We therefore hold that the District may constitutionally tax the entire net income of the trust.

Chase Manhattan Bank, 689 A.2d at 544-45.

Even more recently, Connecticut's supreme court, in Chase Manhattan Bank v. Gavin, 249 Conn. 172, 733 A.2d 782 (1999), *cert. den.*, 120 S.Ct. 401 (1999), fully embraced and added considerably to the analysis the D.C. Court of Appeals presented in its Chase Manhattan Bank decision. In sum, the two courts that have considered this issue following Quill have rejected the notion that a state under whose laws a testamentary trust was created is constitutionally prohibited from taxing such trusts unless some natural person, some property or some income-producing activity associated with the trust is physically present within the state. Chase Manhattan Bank, 689 A.2d at 544-45; Gavin, 249 Conn. 172, 733 A.2d 782.

Nor am I dependent upon decisions from foreign jurisdictions to resolve this matter. In 1967, the Illinois appellate court had already recognized that Illinois retains continuing and primary jurisdiction over issues involving testamentary trusts created by the will of an Illinois resident probated in an Illinois court. Olheiser v. Shepard, 84 Ill. App. 2d 83, 228 N.E.2d 210 (1st Dist. 1967). Olheiser involved a trust beneficiary's action to compel a trustee who lived in Wisconsin to turn over trust assets held by the trustee.

As is the case here, the trust in Olheiser was created by a will of a decedent who, at the time of his death, was a resident of Illinois, and which was probated in Cook County, Illinois in 1941. Olheiser, 84 Ill. App. 2d at 84, 228 N.E.2d at 210. The assets of the testamentary trust in Olheiser, as in this case, consisted of securities. *Id.* The Wisconsin trustee was appointed successor trustee in 1953. In 1966, twenty-five years after the will that created the testamentary trust was probated, the income beneficiary died, after which the residuary beneficiaries sought to have the trustee deliver the trust assets (the securities) to them. He refused, unless he was paid a sum certain for services rendered.

The beneficiaries sought relief in the equity court of Cook County, Illinois, where the trustee filed a special and limited appearance in which he contested the court's exercise of in personam jurisdiction over him. Olheiser, 84 Ill. App. 2d at 85, 228 N.E.2d at 211. The trustee claimed that the Due Process Clause of the United States Constitution prevented him from being hauled into an Illinois court to defend his supervision of the trust, because he lacked the "minimum contacts" with Illinois required before he could be forced to defend any actions involving the trust. Olheiser, 84 Ill. App. 2d at 86-88, 228 N.E.2d at 212-13.

When resolving the issue, the court stated:

> … we believe the rules and principles applied to testamentary trusts and trustees should be used as the guidelines to determine the issue here.
>
> In addition to their general and inherent jurisdiction over trusts and actions to establish and enforce them, courts of equity have the right to exercise a supervisory control over trustees, and a trustee appointed by a court of equity is particularly within its control and subject to its decrees. Whenever, by the appointment of a trustee, a court has taken jurisdiction of the administration and execution of a trust, it has been held that it may require that all acts done thereafter by the trustee be done with its direction or with its sanction. Generally speaking, jurisdiction of the parties is essential to equity's power to determine controversies with respect to the establishment and enforcement of trusts, and such jurisdiction may be acquired in accordance with general rules. [citations omitted] **If a court obtains jurisdiction over a party to an action, that jurisdiction continues throughout all subsequent proceedings which arise out of the original cause of action. The rule of law is well settled that the courts of the testator's domicile and of the state in which the will is probated have primary jurisdiction over testamentary trusts.** A testamentary trustee, acting under court supervision cannot step across the state line with the portable trust assets in his pocket, and then defy the supervising court to remove him.

Olheiser, 84 Ill. App. 2d at 90-91, 228 N.E.2d at 214. After noting that the successor trustee's appointment took place after being approved by an Illinois court, the court affirmed the circuit court's in personam jurisdiction over the trustee. *Id*., 84 Ill. App. 2d at 92-93, 228 N.E.2d at 215.

The Illinois appellate court's decision in Olheiser and the portion of the Supreme Court's decision involving due process in Quill were both influenced by the Court's seminal decision in International Shoe Co. v. Washington, 326 U.S. 310, 66 S.Ct. 154, 90 L.Ed. 95 (1945). *See* Quill, 504 U.S. at 307, 112 S.Ct. at 1910; Ohlheiser, 84 Ill. App. 2d at 91-92, 228 N.E.2d at 214-215. Even before Quill was decided, therefore, the Illinois appellate court recognized that due process does not require that a testamentary trust's trustee, or trust assets, be physically present in Illinois, or that the administration of the trust take place in Illinois, before Illinois could be deemed to have, or before an Illinois court could or would exercise, continuing jurisdiction over the trust and/or its fiduciaries. Olheiser, 84 Ill. App. 2d at 91-93, 228 N.E.2d at 214-15.[3] Since the Supreme Court has held that Due Process nexus for taxation purposes is roughly equivalent to the nexus required for personal jurisdiction (Quill, 504 U. S. at 306-08, 319, 112 S.Ct. at 1910-11; *id* at 319, 112 S.Ct. at 1923 ("It is difficult to discern any principled basis for distinguishing between jurisdiction to regulate and jurisdiction to tax.") (J. Scalia, concurring)), and since Illinois law is "well settled that the courts of the testator's domicile and of the state in which the will is probated have primary jurisdiction over testamentary trusts" (Olheiser, 84 Ill. App. 2d at 90-91, 228 N.E.2d at 214), I cannot recommend that judgment be granted to taxpayer.

In order to accept the Trust's argument that due process requires that some natural person associated with the trust, or some trust property, be physically present in Illinois before Illinois may tax it, I would have to conclude that §§ 1501(a)(20)(C) and 301(a) of the IITA, as applied here, are unconstitutional. That I cannot do. First, statutes are presumed constitutional. Gejа's Cafe v. Metropolitan Pier & Exposition Authority, 153 Ill. 2d 239, 248 (1992). Second, the Department, as a state agency, is not empowered to declare a legislative act unconstitutional (*see* 20 **ILCS** 2505/39b

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[3] There is no mention in Olheiser of whether any of the residuary beneficiaries resided in Illinois, nor does it appear to have mattered. The court clearly determined that it had personal jurisdiction over the trustee because of the court's continuing and primary jurisdiction over the trust itself. Olheiser, 84 Ill. App. 2d at 92-93, 228 N.E.2d at 214-215.

(Powers of the Department)), as is a court, pursuant to Article VI of the Illinois Constitution. *See* Ill. Const., art. VI, § 1. Finally, the undisputed facts of this matter do not require that judgment be entered for the Trust, as a matter of constitutional law. As the D.C. Court of Appeals noted after identifying the frequency with which different state's tax laws define the term "resident" to include testamentary trusts created within the state's courts, "[i]f anything, there seems to be something of a consensus, which we are loathe to declare unconstitutional, that the jurisdiction where a testamentary trust is created is the most appropriate jurisdiction to tax trust income." Chase Manhattan Bank, 689 A.2d at 546-47. The real and continuing benefits and protections Illinois affords the Trust are sufficient for requiring it - like all other residents - to pay Illinois income tax for the privilege of earning or receiving income as a resident of Illinois. 35 **ILCS** 5/201(a); Olheiser, 84 Ill. App. 2d at 91-93, 228 N.E.2d at 214-15.

Commerce Clause:

Taxpayer argues that the Commerce Clause of the United States Constitution (U.S. Const., art. I, § 8) precludes Illinois from taxing the income of the Trust because the test the United States Supreme Court announced in Complete Auto Transit v Brady, 430 U.S. 274 (1977), is not met here. The Department asserts that they are. Both parties, however, are arguing over an irrelevancy.

The United States Supreme Court has long acknowledged that residency alone provides the basis for state taxation of all of a resident's income, from whatever source. New York ex rel. Cohn v. Graves, 300 U.S. 308, 312-13, 57 S.Ct. 466, 467-68, 81 L.Ed. 666 (1937). Thus, the Court has repeatedly held that the Commerce Clause does not prohibit a State's authority to tax "the privilege of residence in the State and measure the privilege by net income, including that derived from interstate commerce." Complete Auto, 430 U.S. at 280, 97 S.Ct. at 1080 (*citing* Freeman v. Hewit, 329 U.S. 249, 255, 67 S.Ct. 274, 278, 91 L.Ed2d 265 (1946)). In Oklahoma Tax Commission v. Chickasaw Nation, the Court vigorously reaffirmed Cohn's ruling that a state "may tax *all* the income of its residents, even income earned outside the taxing jurisdiction". Chickasaw Nation, 115 S.Ct. 2214, 2222 (1995) (*citing to and quoting* Cohn, 300 U.S. at 312-13, 57 S.Ct. at 467-68) (emphasis original). The Court distinguished a state's authority to tax the income of its residents with its significantly diminished authority to tax the income of non-residents. Chickasaw Nation, 115 S.Ct. at 2222 n.11 ("For non-residents, in contrast, jurisdictions generally may tax only income

earned within the jurisdiction."). The Court called Cohn's ruling "a well established principle of interstate and international taxation ... [which] has international acceptance." *Id.*, at 2222.

The Illinois supreme court has acknowledged that the four prongs of the Complete Auto test are "four criteria that a State tax *on nonresidents* must meet to save itself from a commerce clause challenge." Geja's Cafe v. Metropolitan Pier & Exposition Authority, 153 Ill. 2d 239, 255 (1992). This dispute involves income tax being imposed on an Illinois resident. Moreover, both the United States Supreme Court and the Illinois Supreme Court agree that "[i]t is not the purpose of the Commerce Clause to protect state residents from their own state taxes." Geja's Cafe, 153 Ill. 2d at 256 (*quoting* Goldberg v. Sweet, 488 U.S. 252, 266, 109 S.Ct. 582, 591, 102 L.Ed. 2d 607, 620 (1989)). In short, the Complete Auto test doesn't apply where a state tax is being applied to one of its residents. *See* Chickasaw Nation, 115 S.Ct. at 2222. Therefore, I conclude, as a matter of law, that the Commerce Clause does not prohibit Illinois from taxing the income of the Trust, even if none of that income was earned from Illinois sources.

Alternative Apportionment

Finally, the Trust's motion argues that § 304(f) of the IITA entitles it to use an alternative method of apportionment. Section 304 is titled, "Business income of persons other than residents", and details how non-residents are supposed to apportion items of business income. 35 **ILCS** 5/304. During the years at issue, § 304(f) provided:

> Sec. 304. Business income of persons other than residents.
>
> * * * *
>
> f) Alternative allocation. If the allocation and apportionment provisions of subsections (a) through (e) do not fairly represent the extent of a person's business activity in this State, the person may petition for, or the Director may require, in respect of all or any part of the person's business activity, if reasonable:
>
> (1) Separate accounting;
>
> (2) The exclusion of any one or more factors;
>
> (3) The inclusion of one or more additional factors which will fairly represent the person's business activities in this State; or

> (4) The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.

35 **ILCS** 5/304(f).

The Department's cross-motion contends that taxpayer is not entitled to alternative apportionment under § 304(f), citing the administrative regulation it promulgated to, *inter alia*, administer § 304(f). Department's Brief, pp. 16-17. That regulation provides taxpayers with specific information regarding the exclusive means by which they might submit a valid petition for alternative apportionment allowed by § 304(f). 86 Ill. Admin. Code § 100.3390(b)-(e). I agree with the Department that the Trust fails to set forth any well-pleaded facts to show that it ever filed a valid petition for alternative apportionment. Since the Trust has apparently never asked the Director for § 304(f) relief, I am unable to recommend that it is entitled to use alternative apportionment, as a matter of law.

More fundamentally, however, the clear and plain text of § 304(f) shows that that section of the IITA is designed to allow either the Director, or a nonresident taxpayer who conducts business inside and outside Illinois, a way to propose the use of an alternative but reasonable means of apportioning the taxpayer's business income, under circumstances where the statutory apportionment formula detailed in § 304(a)-(e) leads to a grossly distorted result. 35 **ILCS** 5/304(f). The "Carmichael" Trust, however, is not a nonresident. Nor did it apportion its income using an apportionment method described in § 304(a)-(e) of the IITA. Like any resident trust, taxpayer allocated all items of its income to Illinois. 35 **ILCS** 5/301(a); 35 **ILCS** 5/306. As a resident testamentary trust, taxpayer is simply not a member of the class to whom § 304(f) was intended to apply. Thus, as a matter of law, the "Carmichael" Trust is not entitled to § 304(f) relief.

Conclusion:

I recommend that the Director deny Taxpayer's Motion for Summary Judgment and grant the Department's Cross-Motion for Summary Judgment. Taxpayer's amended returns should be denied.

2/1/00 _____

Date Administrative Law Judge